

DOCKETED

NOV 10 2010

OPEN MEETING



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MEMORANDUM**ORIGINAL**

RECEIVED

TO: THE COMMISSION

FROM: Utilities Division

DATE: November 10, 2010

2010 NOV 10 P 4:57

AZ CORP COMMISSION
DOCKET CONTROL

RE: IN THE MATTER OF THE JOINT APPLICATION OF PAETEC HOLDING CORP., MCLEODUSA TELECOMMUNICATIONS SERVICES, INC. DBA PAETEC BUSINESS SERVICES AND TALK AMERICA INC DBA CAVALIER TELEPHONE AND CAVALIER BUSINESS FOR APPROVAL TO TRANSFER OF INDIRECT CONTROL OF TALK AMERICA, INC. TO PAETEC HOLDING CORP. (DOCKET NOS. T-03267A-10-0381 AND T-03342A-10-0381)

Introduction

On September 14, 2010, PAETEC Holding Corp. ("Applicant" or "PAETEC") and Talk America, Inc. ("TA") filed an application with the Arizona Corporation Commission ("Commission") seeking expedited approval, or a waiver of the requirements in A.A.C. R14-2-803 pursuant to A.A.C. R14-2-806, in order to complete the transfer of indirect control of TA to PAETEC. On September 17, 2010, the Applicant provided Staff with a copy of the Agreement and Plan of Merger executed on September 12, 2010. On September 23 and 30, 2010, the Applicant responded to email Data Requests for additional information.

Background of Applicants

PAETEC Holding Corp.

PAETEC is a publicly traded Delaware corporation with principal offices located at One PAETEC Plaza, 600 Willow Brook Office Park, Fairport, New York 14450. PAETEC, through its regulated operating subsidiaries, has a presence in 84 of the nation's top 100 metros, serving business customers in 46 states and the District of Columbia. PAETEC has two subsidiaries that operate in Arizona - McLeodUSA Telecommunications Services, LLC d/b/a PAETEC Business Services ("PAETEC Business") and PaeTec Communications, Inc. ("PCI"). In Arizona, PAETEC Business is authorized to provide resold and facilities-based local exchange and exchange access services pursuant to Decision No. 62627, granted on June 9, 2000. PAETEC Business is a Class A utility and has assets in Arizona.

Talk America, Inc.

Cavalier Telephone Corporation ("Cavalier"), a Delaware corporation, is the parent of TA, a Pennsylvania corporation. Cavalier and TA have their principal business offices at 2134 West Laburnum Avenue, Richmond, Virginia 23227. Through its various operating subsidiaries, including TA, Cavalier serves telecommunications business, consumer and government

customers throughout the Midwest, Southeast, Northeast, and Mid- Atlantic. In Arizona, TA is authorized to provide resold interexchange telecommunications services pursuant to Decision No. 64084 granted October 4, 2001. TA is not a Class A utility and does not have any assets located in Arizona.

The Applicants' Transaction

PAETEC and TA in their application represent the following:

1. Pursuant to the Agreement and Plan of Merger dated September 12, 2010, PAETEC and Cavalier will merge with PAETEC resulting as the ultimate parent of Cavalier and its subsidiary TA.
2. The current customers of TA will remain customers of TA following the merger. As such, the Cavalier transfer will be virtually seamless to customers, who will continue with the same rates, terms and conditions of service as prior to the transfer. The only change resulting from the Cavalier transfer will be the ownership of TA by PAETEC, already the ultimate parent of PAETEC Business and PCI.
3. PAETEC believes it is managerially, technically, and financially well-qualified to become the new owner of TA. Supported by experienced PAETEC management, TA will have the managerial, technical and financial qualifications to provide high quality telecommunications services to consumers in Arizona. TA will also be supported by the financial resources of PAETEC.

The Applicants Request

The Applicants seek review and approval of this transaction without a hearing under A.A.C. R14-2-803. Additionally, the Applicants seek a waiver of the A.A.C. R14-2-803 requirement for a Notice of Intent to be filed at least 120 days prior to reorganization in order for the proposed transaction to be approved before end of year 2010.

Staff's Analysis and Conclusions

PAETEC Business, more commonly known as McLeodUSA, has been a competitive local exchange carrier ("CLEC") providing telecommunications services in Arizona for approximately 10 years. The CLEC has been an active participant in many CLEC matters before the Commission, such as the approval processes under Section 271 and 272 Telecom Act, the Arizona Universal Service Fund and Intrastate Switched Access matters.

TA's 2009 Annual Report confirms that TA at present is not a Class A utility. TA's current interexchange operations in Arizona serve less than 100 customers, the majority of which are business customers.

The Applicants submitted the information required by A.A.C. R14-2-803.A. In their submission, the Applicants explained that:

- PAETEC will not issue additional equity in connection with the proposed transaction. The financing arrangement approved by the Commission in Docket No. T-03267A-10-0358 will be used to finance the proposed transaction.
- The capital structure of the Arizona operating subsidiaries of both PAETEC and Cavalier will be unaffected by the Merger.
- PAETEC's approach to allocating tax liability will not change materially as a result of the proposed transaction.
- The proposed transaction is not expected to have any adverse impact on the cost of services provided by TA and the PAETEC subsidiaries. The proposed transaction should improve all of the operating subsidiaries' access to capital at favorable rates through their common parent, PAETEC.
- TA and the PAETEC subsidiaries will be able to attract capital on terms no less favorable than prior to the proposed transaction. Adequate, and probably increased, capital will be available for growth and development in Arizona.
- There are no current plans for diversification or business activities unrelated to operations of the current subsidiaries.

The Applicants plan to send TA customers a "notice letter/welcome package" about TA joining the PAETEC family of companies. The notice/package will explain that TA customers will continue to be served by TA under current tariffs. Only TA's ultimate parent will change upon execution of the proposed transaction. The Applicants have explained that notice/package materials have not yet been prepared but will be similar to post-merger materials sent in the PAETEC/McLeodUSA merger, Docket No. T-03267A-07-0554.

An advance copy of the legal notice was provided to Staff on September 24, 2010. An affidavit of publication was filed by the Applicants on October 5, 2010. The legal notice was published in the Arizona Business Gazette on September 30, 2010.

Pursuant to Section 3.1 of the Agreement and Plan of Merger, the proposed transaction closing will occur no later than the second business day after conditions in Sections 8.1 and 8.2 have been satisfied, however. June 30, 2011 is the date on which either party can terminate the Agreement and Plan of Merger if closing has not occurred. The Applicants, however, seek approval before end-of-year 2010 and propose to close the transaction well before June 30, 2011 for the following reasons:

- From an accounting and tax perspective, closing the transaction before year end 2010 will be beneficial because financial reporting for 2011 will reflect integrated operations, thus eliminating the need for pro forma financial reporting of 2011 results. In addition, there will be significant benefits related to the volume of Tax filings required in 2011 if the transaction closes in 2010. If the transaction does not close until sometime in 2011, then PAETEC and Cavalier will be required to make "stub" tax filings to cover partial year reporting of separate operations, which can be avoided.
- From a business operational perspective, the transaction is expected to generate \$25M in synergies in year 1. Thus, the passing of each month as separate entities delays the realization of an estimated \$2.1 in monthly merger synergies.
- From a Financial performance perspective, the bond market that will be accessed to finance the retirement of Cavalier's outstanding debt once the deal is closed is currently favorable to financing such offerings. Delaying the closing into 2011 may result in PAETEC accessing the bond market when available financing terms are materially less advantageous. Higher monthly debt carrying costs would reduce the amount of funds PAETEC has available to make capital investments in network infrastructure, data centers, or to develop and offer new products and services.
- From a regulatory reporting perspective, certain regulatory reporting is filed on a consolidated basis for all certificated LECs of PAETEC Holding Corp. If the transaction does not close until sometime in 2011, that delay would require PAETEC and Cavalier to adjust certain regulatory reports to reflect partial year reporting as separate entities.

The Applicants' request to waive the A.A.C. R14-2-803 requirement for a Notice of Intent to be filed at least 120 days prior to reorganization is driven by the Applicants' interest in closing by end of year 2010. Since the Application was filed on September 14, 2010, the Commission's approval for the proposed transaction at the December 14, 2010 Open Meeting would equal only 91 days notice and, therefore, not complying with the 120 notice requirement.

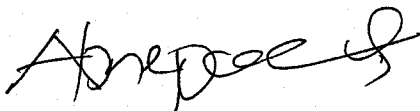
The Applicants have indicated to Staff that no merger-related plans to reduce the Arizona employee-base or company assets of the joint Applicants' operations exist at this time. The Applicants have been found to be in compliance and good standing by the Commission's Compliance and Consumer Services sections. No party has filed objections to this transaction.

Staff's Recommendations

Staff recommends that the application filed by PAETEC and TA seeking expedited approval, or a waiver of the requirements in A.A.C. R14-2-803 pursuant to A.A.C. R14-2-806, in

order to complete the transfer and change indirect control of TA to PAETEC be approved with the following conditions:

1. That for one year following the closing of the proposed transaction, or until the Applicants inform the Commission by filing an affidavit with Docket Control that transaction-related activities are completed, whichever occurs last, the Applicants provide written notification to the Director of the Utilities Division and to the individual members of the Commission, at least 60 days in advance, of any planned acquisition-related Arizona workforce layoffs; any planned acquisition-related Arizona plant closings; and any planned acquisition-related Arizona facility closings.
2. That the Applicants provide Commission Staff with updates by April 15, 2011 and April 15, 2012 on the status of plans related to the proposed transaction to increase employees and investment in Arizona.
3. That the Applicants provide Commission Staff with updates by April 15, 2011 and April 15, 2012 of any changes in the status of debt financing plans.
4. That the Applicants provide Commission Staff with a copy of the post-merger customer notice/packages use to inform customers of the proposed transaction. The copy should be provided within 30 of the issuance of such notice/package to all customers.

for 
Steven M. Olea
Director
Utilities Division

SMO:AFF:lhmkR

ORIGINATOR: Armando F. Fimbres

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 KRISTIN K. MAYES

Chairman

3 GARY PIERCE

Commissioner

4 PAUL NEWMAN

Commissioner

5 SANDRA D. KENNEDY

Commissioner

6 BOB STUMP

Commissioner

7
8 IN THE MATTER OF THE JOINT
9 APPLICATION OF PAETEC HOLDING
10 CORP., MCLEODUSA
11 TELECOMMUNICATIONS SERVICES,
12 INC. DBA PAETEC BUSINESS SERVICES
13 AND TALK AMERICA INC DBA
14 CAVALIER TELEPHONE AND CAVALIER
15 BUSINESS FOR APPROVAL TO
16 TRANSFER OF INDIRECT CONTROL OF
17 TALK AMERICA, INC. TO PAETEC
18 HOLDING CORP.

DOCKET NOS. T-03267A-10-0381

T-03342A-10-0381

DECISION NO. _____

ORDER

16 Open Meeting
17 November 22 and 23, 2010
18 Phoenix, Arizona

18 BY THE COMMISSION:

19 FINDINGS OF FACT

20 1. On September 14, 2010, PAETEC Holding Corp. ("Applicant" or "PAETEC") and
21 Talk America, Inc. ("TA") filed an application with the Arizona Corporation Commission
22 ("Commission") seeking expedited approval, or a waiver of the requirements in A.A.C. R14-2-803
23 pursuant to A.A.C. R14-2-806, in order to complete the transfer of indirect control of TA to
24 PAETEC.

25 2. On September 17, 2010, the Applicant provided Staff with a copy of the Agreement
26 and Plan of Merger executed on September 12, 2010. On September 23 and 30, 2010, the
27 Applicant responded to email Data Requests for additional information.

28 ...

1 Background of Applicants

2 PAETEC Holding Corp.

3 3. PAETEC is a publicly traded Delaware corporation with principal offices located at
4 One PAETEC Plaza, 600 Willow Brook Office Park, Fairport, New York 14450. PAETEC,
5 through its regulated operating subsidiaries, has a presence in 84 of the nation's top 100 metros,
6 serving business customers in 46 states and the District of Columbia. PAETEC has two
7 subsidiaries that operate in Arizona - McLeodUSA Telecommunications Services, LLC d/b/a
8 PAETEC Business Services ("PAETEC Business") and PaeTec Communications, Inc. ("PCI").

9 4. In Arizona, PAETEC Business is authorized to provide resold and facilities-based
10 local exchange and exchange access services pursuant to Decision No. 62627, granted on June 9,
11 2000. PAETEC Business is a Class A utility and has assets in Arizona.

12 Talk America, Inc.

13 5. Cavalier Telephone Corporation ("Cavalier"), a Delaware corporation, is the parent
14 of TA, a Pennsylvania corporation. Cavalier and TA have their principal business offices at 2134
15 West Laburnum Avenue, Richmond, Virginia 23227. Through its various operating subsidiaries,
16 including TA, Cavalier serves telecommunications business, consumer and government customers
17 throughout the Midwest, Southeast, Northeast, and Mid- Atlantic.

18 6. In Arizona, TA is authorized to provide resold interexchange telecommunications
19 services pursuant to Decision No. 64084 granted October 4, 2001. TA is not a Class A utility and
20 does not have any assets located in Arizona.

21 The Applicant's Transaction

22 PAETEC and TA in their application represent the following:

23 7. Pursuant to the Agreement and Plan of Merger dated September 12, 2010, PAETEC
24 and Cavalier will merge with, PAETEC resulting as the ultimate parent of Cavalier and its
25 subsidiary TA.

26 8. The current customers of TA will remain customers of TA following the merger.
27 As such, the Cavalier transfer will be virtually seamless to customers, who will continue with the
28 same rates, terms and conditions of service as prior to the transfer. The only change resulting from

1 the Cavalier transfer will be the ownership of TA by PAETEC, already the ultimate parent of
2 PAETEC Business and PCI.

3 9. PAETEC believes it is managerially, technically, and financially well-qualified to
4 become the new owner of TA. Supported by experienced PAETEC management, TA will have
5 the managerial, technical and financial qualifications to provide high quality telecommunications
6 services to consumers in Arizona. TA will also be supported by the financial resources of
7 PAETEC.

8 The Applicants Request

9 10. The Applicants seek review and approval of this transaction without a hearing
10 under A.A.C. R14-2-803. Additionally, the Applicants seek a waiver of the A.A.C. R14-2-803
11 requirement for a Notice of Intent to be filed at least 120 days prior to reorganization in order for
12 the proposed transaction to be approved before end of year 2010.

13 Staff's Analysis & Recommendations

14 11. PAETEC Business, more commonly known as McLeodUSA, has been a
15 competitive local exchange carrier ("CLEC") providing telecommunications services in Arizona
16 for approximately 10 years. The CLEC has been an active participant in many CLEC matters
17 before the Commission, such as the approval processes under Section 271 and 272 Telecom Act,
18 the Arizona Universal Service Fund and Intrastate Switched Access matters.

19 12. TA interexchange operations in Arizona have declined significantly since 2001
20 when TA reported substantial intrastate revenues. TA's 2009 Annual Report confirms that TA at
21 present is not a Class A utility. Current TA's interexchange operations in Arizona serve less than
22 100 customers, the large majority business customers.

23 13. As TA does not serve local exchange customers, this transaction will not impact the
24 local exchange competitive situation. The total 2009 intrastate interexchange service revenues
25 reported by TA and PAETEC Business do not equal the intrastate interexchange service revenues
26 of TA in 2001. It is, therefore, reasonable to assume that the proposed merger will not
27 immediately give rise to an interexchange carrier that will negatively impact the interexchange
28 competitive situation.

1 14. The Applicants submitted the information required by A.A.C. R14-2-803.A. In
2 their submission, the Applicants explained that:

- 3 a. PAETEC will not issue additional equity in connection with the proposed
4 transaction. The financing arrangement approved by the Commission in
5 Docket No. T-03267A-10-0358 will be used to finance the proposed
6 transaction.
- 7 b. The capital structure of the Arizona operating subsidiaries of both PAETEC
8 and Cavalier will be unaffected by the Merger.
- 9 c. PAETEC's approach to allocating tax liability will not change materially as a
10 result of the proposed transaction.
- 11 d. The proposed transaction is not expected to have any adverse impact on the
12 cost of services provided by TA and the PAETEC subsidiaries. The proposed
13 transaction should improve all of the operating subsidiaries' access to capital at
14 favorable rates through their common parent, PAETEC.
- 15 e. TA and the PAETEC subsidiaries will be able to attract capital on terms no less
16 favorable than prior to the proposed transaction. Adequate, and probably
17 increased, capital will be available for growth and development in Arizona.
- 18 f. There are no current plans for diversification or business activities unrelated to
19 operations of the current subsidiaries.

20 15. The Applicants plan to send TA customers a notice letter/"welcome package" about
21 TA joining the PAETEC family of companies. The notice/package will explain that TA customers
22 will continue to be served by TA under current tariffs. Only TA's ultimate parent will change
23 upon execution of the proposed transaction. The Applicants have explained that notice/package
24 materials have not yet been prepared but will be similar to post-merger materials sent in the
25 PAETEC/McLeodUSA merger, Docket No. T-03267A-07-0554.

26 16. An advance copy of the legal notice was provided to Staff on September 24, 2010.
27 An affidavit of publication was filed by the Applicants on October 5, 2010. The legal notice was
28 published in the Arizona Business Gazette on September 30, 2010.

 17. Pursuant to Section 3.1 of the Agreement and Plan of Merger, the proposed
transaction closing will occur no later than the second business day after conditions in Sections 8.1
and 8.2 have been satisfied, however. June 30, 2011 is the date on which either party can terminate

1 the Agreement and Plan of Merger if closing has not occurred. The Applicants, however, seek
2 approval before end-of-year 2010 and propose to close the transaction well before June 30, 2011
3 for the following reasons:

- 4 a. From an accounting and tax perspective, closing the transaction before year
5 end 2010 will be beneficial because financial reporting for 2011 will reflect
6 integrated operations, thus eliminating the need for pro forma financial
7 reporting of 2011 results. In addition, there will be significant benefits related
8 to the volume of Tax filings required in 2011 if the transaction closes in 2010.
9 If the transaction does not close until sometime in 2011, then PAETEC and
10 Cavalier will be required to make "stub" tax filings to cover partial year
11 reporting of separate operations, which can be avoided.
- 12 b. From a business operational perspective, the transaction is expected to
13 generate \$25M in synergies in year 1. Thus, the passing of each month as
14 separate entities delays the realization of an estimated \$2.1 in monthly merger
15 synergies.
- 16 c. From a Financial performance perspective, the bond market that will be
17 accessed to finance the retirement of Cavalier's outstanding debt once the deal
18 is closed is currently favorable to financing such offerings. Delaying the
19 closing into 2011 may result in PAETEC accessing the bond market when
20 available financing terms are materially less advantageous. Higher monthly
21 debt carrying costs would reduce the amount of funds PAETEC has available to
22 make capital investments in network infrastructure, data centers, or to develop
23 and offer new products and services.
- 24 d. From a regulatory reporting perspective, certain regulatory reporting is filed
25 on a consolidated basis for all certificated LECs of PAETEC Holding Corp. If
26 the transaction does not close until sometime in 2011, that delay would require
27 PAETEC and Cavalier to adjust certain regulatory reports to reflect partial year
28 reporting as separate entities.

18. The Applicants' request to waive the A.A.C. R14-2-803 requirement for a Notice of
Intent to be filed at least 120 days prior to reorganization is driven by the Applicants' interest in
closing by end of year 2010. Since the Application was filed on September 14, 2010, the
Commission's approval for the proposed transaction at the December 14, 2010 Open Meeting
would equal only 91 days notice and, therefore, not comply with the 120 notice requirement.

19. The Applicants have indicated to Staff that no merger-related plans to reduce the
Arizona employee-base or company assets of the joint Applicants' operations exist at this time.

1 The Applicants have been found to be in compliance and good standing by the Commission's
2 Compliance and Consumer Services sections. No party has filed objections to this transaction

3 20. Staff recommends that the application filed by PAETEC and TA seeking expedited
4 approval for a one-time waiver of the requirements in A.A.C. R14-2-803 pursuant to A.A.C. R14-
5 2-806 in order to complete the transfer and change indirect control of TA to PAETEC be approved
6 with the following conditions:

- 7 a. That for one year following the closing of the proposed transaction or until the
8 Applicants inform the Commission by filing an affidavit with Docket Control
9 that transaction-related activities are completed, whichever occurs last, the
10 Applicants provide written notification to the Director of the Utilities Division
11 and to the individual members of the Commission, at least 60 days in advance,
12 of any planned acquisition-related Arizona workforce layoffs; any planned
13 acquisition-related Arizona plant closings; and any planned acquisition-related
14 Arizona facility closings.
- 15 b. That the Applicants provide Commission Staff with updates by April 15, 2011
16 and April 15, 2012 on the status of plans related to the proposed transaction to
17 increase employees and investment in Arizona.
- 18 c. That the Applicants provide Commission Staff with updates by April 15, 2011
19 and April 15, 2012 of any changes in the status of debt financing plans.
- 20 d. That the Applicants provide Commission Staff with a copy of the post-merger
21 customer notice/packages use to inform customers of the proposed transaction.
22 The copy should be provided within 30 of the issuance of such notice/package
23 to all customers.

24 CONCLUSIONS OF LAW

25 1. PAETEC Holding Corp. and Talk America, Inc. are public service corporations
26 within the meaning of Article XV of the Arizona Constitution and A.R.S. § 40-285.

27 2. The Commission has jurisdiction over PAETEC Holding Corp. and Talk America,
28 Inc. and the subject matter in this filing.

3. The Commission, having reviewed the filing and Staff's Memorandum dated
November 10, 2010, concludes that it is in the public interest to grant approval for the Applicants
to encumber assets as proposed in the financing arrangement discussed herein.

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ORDER

IT IS THEREFORE ORDERED that the application of PAETEC Holding Corp. and Talk America, Inc. seeking expedited approval for a waiver of the requirements in A.A.C. R14-2-803 pursuant to A.A.C. R14-2-806 in order to complete the transfer and change indirect control proposed herein, be and hereby is approved.

IT IS FURTHER ORDERED that PAETEC Holding Corp. and Talk America, Inc. be authorized to engage in any transactions and to execute any documents necessary to effectuate the authorizations granted.

IT IS FURTHER ORDERED that for one year following the closing of the proposed transaction or until PAETEC Holding Corp. and Talk America, Inc. inform the Commission by filing an affidavit with Docket Control that transaction-related activities are completed, whichever occurs last, the Applicants provide written notification to the Director of the Utilities Division and to the individual members of the Commission, at least 60 days in advance, of any planned acquisition-related Arizona workforce layoffs; any planned acquisition-related Arizona plant closings; and any planned acquisition-related Arizona facility closings.

IT IS FURTHER ORDERED that PAETEC Holding Corp. and Talk America, Inc. provide Commission Staff with updates by April 15, 2011 and April 15, 2012 on the status of plans related to the proposed transaction to increase employees and investment in Arizona.

IT IS FURTHER ORDERED that PAETEC Holding Corp. and Talk America, Inc. provide Commission Staff with updates by April 15, 2011 and April 15, 2012 of any changes in the status of debt financing plans.

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1 IT IS FURTHER ORDERED that PAETEC Holding Corp. and Talk America, Inc. provide
2 Commission Staff with a copy of the post-merger customer notice/packages use to inform
3 customers of the proposed transaction. The copy should be provided within 30 days of the
4 issuance of such notice/package to all customers.

5 IT IS FURTHER ORDERED that this Decision become effective immediately.

6
7 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

8
9
10 CHAIRMAN

COMMISSIONER

11
12 COMMISSIONER

COMMISSIONER

COMMISSIONER

13
14 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,
15 Executive Director of the Arizona Corporation Commission,
16 have hereunto, set my hand and caused the official seal of
17 this Commission to be affixed at the Capitol, in the City of
18 Phoenix, this _____ day of _____, 2009.

19
20 _____
ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

21 DISSENT: _____

22
23 DISSENT: _____

24 SMO:AFF:lhml
25
26
27
28

1 SERVICE LIST FOR MCLEODUSA TELECOMMUNICATIONS SERVICES, INC.,
2 TALK AMERICA INC

3 DOCKET NOS. T-03267A-10-0381, T-03342A-10-0381

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